

Financial Management Circular: #2014-2

Effective Date: July 1, 2014

General Subject: **Employee Reimbursement – When is it taxable or non-taxable?**

Authority: IC 4-12-1-13(f)

Application: This circular applies to all instrumentalities (hereinafter referred to as “State agencies”) of the Executive, Legislative, and Judicial Branches, including all bodies corporate and politic.

Summary:

When a state agency reimburses an employee for an expense, it must decide whether that reimbursement should be taxed. The IRS refers to these decisions on different categories of reimbursements as “plans,” which are either “accountable” (this means not taxed) or “non-accountable” (this means taxed). The IRS does not require amounts paid under accountable plans to be taxed as income. On the other hand, the IRS does require amounts paid under a non-accountable plan to be treated as income to the employee and, thus, must be included in wages with appropriate tax withholdings deducted. The following definitions and examples guide agencies in deciding what reimbursements are non-taxable and which ones are taxable to the employee.

Accountable Plans (**not taxable**):

Definition: A plan under which an employee is reimbursed for expenses or receives an allowance to cover expenses is an accountable reimbursement plan only if the following conditions are satisfied:

1. A business condition exists for the expense (i.e., the expense is in connection with performance of services as an employee),
2. The expenses are substantiated through:
 - a. Receipts and/or cancelled checks and invoices that show the nature and amount of the expenditure, or
 - b. The mileage reimbursement rate and use of a per diem rate for overnight travel are acceptable rather than requiring receipts for vehicle operation and meals.

Examples: In addition to mileage reimbursements and per diem payments, other acceptable examples of expenses in an accountable reimbursement plan would include:

1. INDOT provided a tool allowance to the mechanics in their agency and reimburses the mechanics when a receipt is provided.
2. A state employee pays the registration fees for a conference, and his or her agency reimburses the employee when a receipt is provided.

Reimbursement Timeframe: To qualify for a non-taxable reimbursement under an accountable plan, employees must submit receipts (or other forms of substantiation) within 60 days of the expenditure.

Taxability: Amounts paid under accountable plans are not considered income to the employee and should be processed through accounts payable. These reimbursements are not subject to income taxes and are not shown on a Form W-2.

Non-accountable plans (taxable):

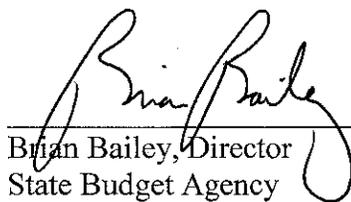
Definition: A non-accountable reimbursement plan is a reimbursement plan or policy which does not meet all the conditions for an accountable reimbursement plan (no business condition, no receipts, etc.).

Examples of expenses in a non-accountable reimbursement plan include:

1. Spot bonus payments and other bonus payments.
2. An agency provides each employee with \$100 each year for nursing scrubs without requiring receipts substantiating the actual purchases.
3. Any non-cash awards (fitness tracking devices, plaques, medallions, etc).

Taxability: The IRS deems amounts paid under a non-accountable plan as income to the employee, and, thus, these amounts must be included in wages with appropriate tax withholdings.

This Financial Management Circular is not intended to provide an exhaustive list or replace IRS requirements. For additional guidance, please refer to IRS publication 15-B or the Payroll Director within the Office of the Auditor of State.


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06/23/14
Date